

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 03-0225**  
**Gross Income Tax**  
**For the Tax Years 1999, 2000, 2001**

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**ISSUES**

**I. Gross Income Tax-Small Business Exemption**

**Authority:** IC 6-2.1-2-2; IC 6-2.1-3-24.5; I.R.C. § 1361(b); I.R.C. § 1362(a).

Taxpayer protests imposition of gross income tax with respect to taxpayer's subsidiaries.

**II. Tax Administration-Penalty**

**Authority:** IC 6-8.1-10-1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalty for negligence.

**STATEMENT OF FACTS**

Taxpayer consists of a non-resident parent corporation (hereinafter referred to as "Parent"), with two wholly-owned subsidiary corporations and one largely-owned subsidiary corporation, with one of the wholly-owned subsidiaries and the largely-owned subsidiary (hereinafter referred to as "Subsidiaries") at issue. Parent, with thirteen individual shareholders, is a small business company, and thus would qualify for S-Corporation status upon proper election. For taxable years 1999, 2000, and 2001, Parent had not elected to be treated as an S-Corporation.

The Department conducted an audit for taxable years 1999, 2000, and 2001. As a result of the audit, Department assessed gross income tax with respect to the receipts of Subsidiaries, based on their gross income as a result of the conclusion that Subsidiaries were not small business companies. However, Parent's gross income was not subject to gross income tax.

**I. Gross Income Tax-Small Business Exemption**

### **DISCUSSION**

As a general rule, non-resident corporate taxpayers are subject to gross income tax on their gross receipts derived from businesses and activities conducted in Indiana. Ind. Code § 6-2.1-2-2(a)(2) (repealed effective January 1, 2003). However, under Ind. Code § 6-2.1-3-24.5(b), a corporation which qualifies as a small business corporation is exempt from Gross Income Tax. For Gross Income Tax purposes, a small business corporation is defined as having the same definition that term has in I.R.C. § 1361(b). Ind. Code § 6-2.1-3-24.5(a).

Parent qualifies as a small business corporation within the statutory definition of I.R.C. § 1361(b)(1). However, Parent is not an S-Corporation due to the fact that it has not elected such status under I.R.C. § 1362(a).

Subsidiaries are not small business corporations due to the fact that the Subsidiaries have a corporate shareholder, which renders Subsidiaries ineligible for such status under I.R.C. § 1361(b)(1)(B), which limits the scope of permissible shareholders to various persons or entities, but generally does not permit ownership by another for-profit corporation.

Taxpayer maintains that, because the Parent is eligible for S-Corporation treatment within I.R.C. § 1361(b), Subsidiaries are eligible by virtue of I.R.C. § 1361(b)(3), which provides that domestic corporations wholly owned by an S-Corporation are disregarded as a separate entity, and treated as part of the parent S-Corporation for tax purposes. However, at the very least, such status requires the parent corporation elect to be treated as an S-Corporation, which Parent did not do in this case. Further, one of the Subsidiaries was not wholly owned by Parent, which rendered that company outside the definition provided by I.R.C. § 1361(b)(3). Thus, Subsidiaries were not small business corporations within the meaning of the statute, and gross income tax was properly assessed.

### **FINDING**

Taxpayer's protest is denied.

## **II. Tax Administration-Penalty**

### **DISCUSSION**

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10. The Indiana Administrative Code further provides in 45 IAC 15-11-2:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow

instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has presented sufficient information that the taxpayer acted with the level of reasonable care expected of a taxpayer, and accordingly the penalty should be waived.

### **FINDING**

Taxpayer's protest is sustained.